

October 27, 2022

SEC Adopts Rules on Clawback of Executive Compensation

On October 26, 2022, the Securities and Exchange Commission (the “SEC”), implementing a requirement of the Dodd-Frank Act, adopted final rules on the recovery of erroneously awarded incentive-based executive compensation – that is, incentive-based compensation awarded based on a misstated financial performance measure (including stock price and total shareholder return).

The rules primarily require:

- national securities exchanges to establish listing standards that would require listed issuers to adopt and comply with a policy for the recovery of such erroneously awarded compensation (commonly known as a “clawback policy”); and
- listed issuers to disclose information about such policy and their compliance.

The rules apply to most listed issuers, including those that are “emerging growth companies,” “smaller reporting companies” and “foreign private issuers,” with exemptions only for the listing of certain security futures products, standardized options, securities issued by unit investment trusts and securities issued by certain registered investment companies.

An issuer would be subject to delisting if it does not adopt and comply with a clawback policy that is compliant with its exchange’s listing standards.

Effective Dates

The rules will become effective 60 days after publication in the Federal Register, and a national securities exchange’s listing standard must be effective no later than one year after that publication. An issuer subject to the listing standards must adopt its clawback policy, which must apply to all incentive-based compensation received by executive officers on or after the effective date of the applicable listing standard, no later than 60 days after the effective date of the applicable listing standard and must comply with the disclosure requirements of the rules following the date that the issuer’s clawback policy is adopted.

Compensation Recovery and Disclosure Requirements

Under the new rule, an issuer that is required to prepare an accounting restatement, including a “little r restatement” (i.e., a restatement to correct an immaterial error to prior period financial statements that would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period), would be required to recover from any current or former executive officers the incentive-based compensation that was erroneously awarded to such person during the three fiscal years preceding the date such restatement was required (as well as any transition period resulting from a change in the issuer’s fiscal year within or immediately following those three completed fiscal years). For purposes of this rule, the date that a restatement is required is the date that the issuer’s board (or a committee of the board or authorized officers) concludes, or reasonably should have concluded, that the issuer is required to prepare a restatement or, if earlier, the date that a court, regulator or other authorized body directs the issuer to prepare a restatement. In addition, the rule makes clear that an issuer’s obligation to recover excess incentive-based erroneously awarded compensation is not dependent on if or when the restated financial statements are filed. The “erroneously awarded” amount is the excess of the compensation received over the amount that would have been received based on the restated amounts (computed without regard to any taxes paid). The requirement to recover such compensation is, however, subject to limited impracticability exceptions.

The definition of “executive officer” for purposes of this rule tracks the definition of “officer” found in Rule 16a-1(f) under the Securities Exchange Act and includes the issuer’s president, principal financial officer, principal accounting officer (or, if there is no such accounting officer, the controller), any vice-president of the issuer in charge of a principal business unit, division or function as well as any officer who performs a policy-making function (including executive officers of the issuer’s parent(s) or subsidiaries who perform such policy making functions for the issuer).

Recovery of erroneously awarded compensation is required under the new rule regardless of any misconduct by an executive officer in connection with the error that triggers the restatement. In addition, the new rule prohibits issuers from indemnifying their current or former executive officers against the loss of erroneously awarded compensation.

A listed issuer will be required to file its clawback policy as an exhibit to its annual report and to disclose certain information about compliance with its policy, including:

- the aggregate amount of erroneously awarded compensation related to an accounting restatement, including an analysis of how the amount was calculated (using estimates, with the methodology disclosed, for awards based on stock price or total shareholder return);
- the aggregate amount of such erroneously awarded compensation yet to be recovered (or, if such amounts have not yet been determined, the reason therefor);
- the amount due from each current or former named executive officer that remains unrecovered for 180 days or more since the date the issuer determined the amount of such person’s erroneously awarded compensation; and
- details about any reliance on impracticability exceptions and the amount of any such erroneously awarded compensation that will not be recovered.

Issuers will be required to use Inline XBRL to tag their compensation recovery disclosure.

Relatedly, the SEC adopted amendments to the cover pages of the annual reports on Form 10-K, Form 20-F and Form 40-F to add check boxes that indicate (a) whether the financial statements of the registrant included in the filing reflect correction of an error to previously issued financial statements and (b) whether any of those error corrections are restatements that required a recovery analysis of incentive-based compensation received by any of the registrant’s executive officers during the relevant recovery period under the new rule.